

ARTICLES

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A New Regime for International Independent Guarantees and Stand-by Letters of Credit: The UNCITRAL Draft Convention on Guaranty Letters

A major development in the law governing international independent guarantees and stand-by letters of credit will take place during the 1995 session of the United Nations Commission on International Trade Law (UNCITRAL). At that session the UNCITRAL is expected to consider and adopt the draft Convention on International Guaranty Letters.¹ This article gives the status of preparation of the draft convention as of August 1, 1993.²

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1. This is the current working title of the draft convention. U.N. Doc. A/CN.9/372, ¶ 21 (1993). For the use of the term "guaranty letter," see *infra* note 20.

2. At the time this article went to press, one further session of the Working Group preparing the draft convention was scheduled to take place in Fall 1993 and another is anticipated in Spring 1994. Following completion of the draft by the Working Group, it will be sent to all states for comment prior to its submission to the 1995 session of the UNCITRAL. If the final text remains in the form of a draft convention, the UNCITRAL will probably submit it to the General Assembly with the suggestion that it be submitted to a diplomatic conference to be held in early 1997. A first draft of articles 1 to 7 prepared by the Secretariat was contained in U.N. Doc. A/CN.9/WG.II/WP.67 (1990). A redraft of articles 1 to 7 and the first draft of the remainder of the convention prepared by the Secretariat were contained in U.N. Docs. A/CN.9/WG.II/WP.73 and Add.1 (1991). Following discussion of the first draft in two sessions of the Working Group, the Secretariat prepared a second draft, which was submitted to the eighteenth session of the Working Group in U.N. Docs. A/CN.9/

I. Background to the Convention

Independent guarantees and stand-by letters of credit serve the same economic function. The guarantor, or issuer of the stand-by credit, promises to pay the beneficiary a certain sum of money because of the failure of the account party to pay or to perform some other obligation. Independent guarantees and stand-by letters of credit are distinguished from the familiar suretyship in that the beneficiary need not demonstrate the account party's failure; the beneficiary has the right to payment either upon simple demand without justification or upon demand accompanied by one or more specified documents. A required document might be a statement of the beneficiary itself that the account party has failed in its obligation or it might be a statement of a third party as to that failure. In either case the guarantor or issuer of the credit is not interested in the performance or failure to perform; it acts upon receipt of the simple demand, or of the demand and appropriate documents, as the case may be. Although the processing of an independent guarantee or a stand-by letter of credit is identical to that of a commercial documentary letter of credit, the economic function is quite different. The documentary letter of credit serves as a means of payment to the beneficiary when the underlying transaction is properly performed; the independent guarantee and the stand-by letter of credit serve as a means of payment to the beneficiary when the underlying transaction is not properly performed.³

The decision to prepare the convention is closely associated with the UNCITRAL's long-standing involvement in the work of the International Chamber of Commerce (ICC) on the subjects of documentary credits and of guarantees. In conformity with its charge to coordinate the work of other organizations active in the field of international trade law,⁴ the UNCITRAL discussed developments in documentary credits and guarantees regularly from 1968 to 1977.⁵ In 1969 the UNCITRAL recommended the use of the then current 1962 version of the Uniform Customs and Practice for Documentary Credits (UCP), which had been prepared by the ICC.⁶ The UNCITRAL actively collaborated with the ICC in the 1974

WG.II/WP.76 and Add.1 (1992). Additional Secretariat reports are contained in U.N. Docs. A/CN.9/301; A/CN.9/WG.II/WP.65; A/CN.9/WG.II/WP.68 (1990); A/CN.9/WG.II/WP.70 (1991); and A/CN.9/WG.II/WP.71. Reports of the twelfth through nineteenth sessions of the Working Group (the meetings at which the preparation of the convention has been discussed) are contained in U.N. Docs. A/CN.9/316 (1988); A/CN.9/330 (1990); A/CN.9/342 (1990); A/CN.9/345 (1991); A/CN.9/358 (1992); A/CN.9/361 (1991); A/CN.9/372 (1993); A/CN.9/374 and Corr. 1 (1993).

3. See *infra* text accompanying notes 26-30.

4. G.A. Res. 2205, pt. 2, ¶ 8, U.N. GAOR, 21st Sess., Supp. No. 16, U.N. Doc. A/6316 (1966).

5. Both subjects were placed on the program of work in *Report of the U.N. Commission on International Trade Law on the Work of its First Session*, U.N. GAOR, 23d Sess., Supp. No. 16, ¶ 48, U.N. Doc. A/7216 (1968) [hereinafter *Report, First Session*]. Discussion by the Commission is contained in each of the annual reports through 1977.

6. *Report of the U.N. Commission on International Trade Law on the Work of its Second Session*, U.N. GAOR, 24th Sess., Supp. No. 18, ¶ 95, Doc. A/7618 (1969) [hereinafter *Report, Second Session*].

revision of the UCP and, after the ICC adopted the revision, the UNCITRAL recommended its use.⁷ In view of the evident success of the UCP, the UNCITRAL encouraged the ICC to undertake the preparation of an equivalent set of rules to govern guarantees.⁸ However, when the ICC adopted the Uniform Rules on Contract Guarantees (URCG) in 1978, it did not request the UNCITRAL to recommend their use, and the UNCITRAL did not do so on its own initiative.⁹ The UCP was again before the UNCITRAL in 1982 when that organization discussed the status of preparation in the ICC of what became the 1983 version of the UCP. The new version was expected to provide that the UCP applied to stand-by credits.¹⁰ During the discussion in the UNCITRAL:

A proposal was made that the Secretariat should be requested to make a study of the use of letters of credit, especially for purposes other than the sale of goods, to see whether the current law was adequate. It was pointed out that letters of credit were originally intended to be used in connexion with the documentary sale of goods. Currently they are used for a number of other purposes, such as in connexion with bid bonds and re-purchase agreements. It was suggested that the legal rules developed for the one

7. *Report of the U.N. Commission on International Trade Law on the Work of its Eighth Session*, U.N. GAOR, 30th Sess., Supp. No. 17, ¶ 41, U.N. Doc. A/10017 (1975) [hereinafter *Report, Eighth Session*]; see also U.N. Doc. A/CN.9/101/Add.1 (1975) for an analysis of the 1974 version of the UCP in light of the comments that had been received by the UNCITRAL, largely from Eastern Europe and developing countries. The replies were in response to a questionnaire, originally prepared by the ICC for its national committees, that had been sent by the UNCITRAL to all states at the request of the ICC.

8. See *Report of the U.N. Commission on International Trade Law on the Work of its Third Session*, U.N. GAOR, 25th Sess., Supp. No. 17, ¶¶ 130-38, U.N. Doc. A/8017 (1970) [hereinafter *Report, Third Session*]; *Report, Eighth Session*, *supra* note 7, ¶¶ 42-46.

9. The ICC Publication No. 325. Although it is not in the record, the reason why the URCG was not submitted to the UNCITRAL for its endorsement was that the URCG did not admit the possibility of simple demand guarantees (i.e., guarantees payable upon the simple demand of the beneficiary without justification) whether documentary or otherwise. Simple demand guarantees are also referred to as first demand guarantees. See *infra* text accompanying notes 43-50. Since the UNCITRAL Secretariat was not satisfied that the URCG met the needs of international commerce as it had evolved, the distinct possibility existed that the UNCITRAL would reject the request for endorsement if it were made, a situation that would have been embarrassing for all concerned. The URCG is rarely referred to in international contracts. Lars A.E. Hjerner, *Contract Guarantees*, in *INTERNATIONAL CONTRACTS AND PAYMENTS* 77-78 (P. Šarčević & P. Volken eds., 1991). Nevertheless, since it is used by some banks, particularly in Scandinavia, when the ICC adopted the Uniform Rules for Demand Guarantees (URDG) in December 1991, it said that the URCG "will continue to be available for the time being for those who wish to use it and its future will be reviewed at a later date in the light of experience of the new Rules." Foreword, Uniform Rules for Demand Guarantees (URDG), ICC Publication No. 458, at 2. See *infra* note 13.

10. The Secretariat report to the UNCITRAL discussed this likelihood. U.N. Doc. A/CN.9/229, ¶ 12 (1989). Although article 1 of the 1983 version of the UCP provides that the UCP applies to stand-by letters of credit "to the extent which they may be applicable," there is no explicit indication as to which substantive articles are applicable to stand-bys. This problem remains in the newest revision of the UCP, which has been published as ICC Publication No. 500, with an effective date of January 1, 1994. For example, the comment to what was then draft article 1 states that "the majority of the articles do not apply to the standby credit" with no indication as to which articles are applicable. ICC Document No. 470-37/104 (Sept. 18, 1992).

situation might not be appropriate for these other uses to which letters of credit are currently put.¹¹

By the time the report containing the requested study was submitted to the UNCITRAL in 1988, the ICC had prepared a draft of a new set of rules for independent guarantees that were intended to substitute for, or to supplement, the 1978 URCG. The existence of a draft of new ICC rules that promised to be of use with independent guarantees was of direct relevance to the recommendation contained in the UNCITRAL Secretariat's report since, as therein pointed out, "[b]y its function and purpose, the stand-by letter of credit differs considerably from the traditional commercial letter of credit or documentary credit and is equivalent to independent bank guarantees and similar indemnities."¹² Thus, any work by the UNCITRAL could duplicate the project already well underway in the ICC in respect of independent guarantees.

As a result, the Secretariat suggested, and the UNCITRAL agreed, that a session of an UNCITRAL Working Group should be devoted to consideration of, and comment on, the then existing draft of the ICC Rules. "This would allow the Commission, with its balanced representation of all regions and the various economic and legal systems, to assess the world-wide acceptability of the draft Rules."¹³ In addition to considering the draft ICC Rules, which were of a contractual nature, the Working Group was requested to consider whether the UNCITRAL should prepare a uniform law on the subject.¹⁴ The Working Group made such a recommendation, and the UNCITRAL adopted it.¹⁵

11. *Report on the U.N. Commission on International Trade Law on the Work of its Fifteenth Session*, U.N. GAOR, 37th Sess., Supp. No. 17, ¶ 109, U.N. Doc. A/37/17 (1982). The representative of the ICC stated that his organization looked forward to cooperating in the preparation of the study. *Id.* ¶ 111. Two years later the UNCITRAL "[c]ommend[ed] the use of the 1983 revision [of the UCP], as from 1 October 1984, in transactions involving the establishment of a documentary credit." *Report of the U.N. Commission on International Trade Law on the Work of its Seventeenth Session*, U.N. GAOR, 39th Sess., Supp. No. 17, ¶ 129, U.N. Doc. A/39/17, (1984).

12. U.N. Doc. A/CN.9/301, ¶ 91.

13. *Id.* ¶ 94. The action of the UNCITRAL is found in *Report of the U.N. Commission on International Trade Law on the Work of its Twenty-First Session*, U.N. GAOR, 43rd Sess., Supp. No. 17, ¶ 19, U.N. Doc. A/43/17, (1988) [hereinafter *Report, Twenty-First Session*]. The Working Group's comments on the draft URDG are found in U.N. Doc. A/CN.9/316, ¶¶ 12-121. The ICC adopted the URDG on December 3, 1991. For a discussion of the URDG, see Michael Vasseur, *The New Rules of the International Chamber of Commerce for "Guarantees on Demand"*, 1992 INT'L BUS. L.J. 239; Roy Goode, *The New I.C.C. Uniform Rules for Demand Guarantees*, 1992 LLOYD'S MAR. & COM. L.Q. 190; and, in respect of an earlier draft, Boris Kozolchik, *Bank Guarantees and Letters of Credit: Time for a Return to the Fold*, 11 U. PA. J. INT'L BUS. L. 1, 58-67 (1989). Following adoption of the URDG, the ICC undertook the preparation of a new set of rules on accessory (suretyship type) guarantees for use primarily by insurance companies, entitled Uniform Rules for Contract Bonds. The most recent draft is in ICC Document No. 470/685 (Oct. 12, 1992). The Rules were submitted to the ICC Council for adoption in April 1993.

14. *Report, Twenty-First Session*, *supra* note 13, ¶¶ 23-26.

15. U.N. Doc. A/CN.9/316, ¶¶ 122-23; *Report of the U.N. Commission on International Trade Law on the Work of its Twenty-Second Session*, U.N. GAOR, 44th Sess., Supp. No. 17, ¶ 244, U.N. Doc. A/44/17 (1989). In this context the term "uniform law" referred to any of the various techniques

II. Internationality

When the Working Group made the recommendation that a convention should be prepared, it said that the convention “should be limited to international instruments, in particular, since inclusion of domestic instruments would adversely affect the world-wide acceptability of the [convention].”¹⁶ According to draft article 4(1), “[a] guaranty letter is international if the places of business specified in the guaranty letter of any two of the following persons are in different States: issuer, beneficiary, principal, instructing party [, advisor] or confirmer.”¹⁷

More recently, sentiment for including domestic transactions has increased. As a consequence, the parties to a guaranty letter that is not international will be permitted to choose to have the convention apply to it by simply stating that the letter is subject to the convention.¹⁸

III. Application of the Convention to Independent Guarantees and Stand-by Letters of Credit

At its first meeting on the preparation of the convention, the Working Group decided that the convention should “focus on independent guarantees, including stand-by letters of credit.”¹⁹ In the draft convention both types of instrument are characterized as a “guaranty letter.”²⁰

available to the international community to unify the law. Subsequently, the Working Group decided to proceed on the working assumption that the final text would take the form of a convention without thereby precluding the possibility of reverting to the more flexible form of a model law at the final stage of the work when the Working Group would have a clear picture as to the provisions included in the draft text. U.N. Doc. A/CN.9/361, ¶ 147, reaffirmed, U.N. Doc. A/CN.9/372, ¶ 16. Throughout the remainder of this article the text under preparation will be referred to as the convention.

16. U.N. Doc. A/CN.9/316, ¶ 172.

17. *Id.*

18. U.N. Doc. A/CN.9/372, ¶¶ 68-72.

19. U.N. Doc. A/CN.9/330, ¶ 13. The Working Group went on to say that the convention could also “be extended to traditional commercial letters of credit where that would be useful in view of their independent nature and the need [to regulate] equally relevant issues.” At a subsequent session it “decided to consider at a later stage the question of the inclusion of commercial letters of credit” in the convention. U.N. Doc. A/CN.9/358, ¶ 45. The Working Group has not yet considered the question. For a strong argument that documentary credits should be included, see James E. Byrne, *Fundamental Issues in the Unification and Harmonization of Letter of Credit Law*, 37 LOY. L. REV. 1, 17-18 (1991).

20. “Guaranty letter” has been used by the Working Group as the generic term to cover both the stand-by letter of credit and the independent guarantee. The Working Group was in agreement at its eighteenth session that, if the current approach of largely common provisions was retained, the use of one expression was useful from a drafting point of view. If, however, bank guarantees and stand-by letters of credit are dealt with in separate parts of the convention, as suggested by the United States, *infra* note 36, there would be little need for a common expression. U.N. Doc. A/CN.9/372, ¶¶ 20-21. Therefore, the terminological issue could not be decided until the substantive issue was decided. The delegation of the United States has suggested that, if a generic term is used, it should be “independent undertaking[.]” on the grounds that it “is better balanced than ‘guaranty letter’ (or any other term that uses the word ‘guarantee’).” U.N. Doc. A/CN.9/WG.II/WP.77, ch. 1, art. 1,

The decision to treat independent guarantees and stand-by letters of credit as equivalent legal instruments is in sharp contrast to the decision of the ICC that stand-by letters of credit should continue to be governed by the UCP rather than by the new URDG. The official ICC explanation for treating them separately is that:

Standby credits are already governed by [the UCP]. They have developed into all-purpose financial support instruments which are used in a much wider range of financial and commercial activity than demand guarantees, and regularly involve practices and procedures (e.g. confirmation, issue for a bank's own account, presentation of documents to a party other than the issuer) that are infrequently encountered in relation to demand guarantees and that ally standby credits more closely with documentary credits. Accordingly, while standby credits are technically within the definition of a demand guarantee, it is expected that issuers of standby credits will continue to use the UCP, which are both more detailed and more appropriate to the particular requirements of standby credits.²¹

On its face the decision to treat independent guarantees and stand-by letters of credit together also appears to be inconsistent with current American law. The apparent inconsistency may be explained, at least in part, by the fact that American practice does not use the concept of an independent contractual guarantee.²² Once observers take this into account, the apparent inconsistency is less sharp.²³

The United States, as elsewhere, has traditionally known two forms of promise to pay that are independent of the underlying transaction that gave rise to the promise. The first, of ancient origin, is the negotiable instrument, where the promise to pay becomes truly independent when the instrument comes into the hands of a holder in due course.²⁴ The second, of more recent origin, is the letter of credit, by

cm. 4 (1992). See also article 2 of the current text of the draft convention, U.N. Doc. A/CN.9/WG.II/WP.76, which describes a guaranty letter as an independent undertaking. But see Kozolchik, *supra* note 13, at 69: "[A] term such as 'guarantee letter of credit' may well solve the nomenclature dispute between European and American bankers and banking lawyers."

21. Uniform Rules for Demand Guarantees, Introduction, ICC Publication No. 458, at 4.

22. However, as noted in RESTATEMENT (FIRST) OF SECURITY § 117 cmt. d (1941):

The surety, if he desires, may assume a risk greater than that which would be implied from a mere guaranteeing of the principal's performance. The surety may contract not only as a surety but also as an insurer, that is, that he will indemnify the creditor against loss, irrespective of the continuance or even of the existence of a duty on the part of the principal.

Section 3(2) of the current draft of the *Restatement of Suretyship* provides that it does not apply to stand-by letters of credit. RESTATEMENT (THIRD) OF SURETYSHIP § 3(2) (Tent. Draft No. 1, 1992). Comment c to draft section 3 notes that "demand guarantees" and "international bank guarantees," which have often been treated by American courts as though they were letters of credit governed by letter of credit law, are also outside the scope of the Restatement. *Id.* cmt. c. Comment b suggests that in cases where the law governing letters of credit does not give a solution, the *Restatement* might be looked to for guidance. *Id.* cmt. b.

23. Comment 1 to the proposed redraft of U.C.C. § 5-103 notes the similarity between a guarantee and a letter of credit. However, "[t]his [Article] does not apply to guarantees and it is important that courts recognize the distinction between letters of credit and guarantees." U.C.C. § 5-103 cmt. 1 (Mar. 31, 1993, Draft) [hereinafter Mar. 31, 1993, Draft]. The comment goes on to describe guarantees in suretyship terms. Comment 3 states:

[t]o say that something is a "guarantee" in the typical domestic transaction is to say that the parties intend that particular legal rules apply to it. By acknowledging that something is a guarantee, but asserting that it is to be treated as a "letter of credit," the parties leave a court uncertain about where the rules on guarantees stop and those concerning letters of credit begin.

Id. cmt. 3 (emphasis added).

24. U.C.C. § 3-305 (1989).

which an issuer promises to pay the beneficiary upon demand (clean credit) or when the beneficiary presents to it the documents called for in the letter of credit.

Generally speaking, all other categories of promisor are able to raise various defenses against the promisee, or against a transferee of the promisee's rights. In particular, a guarantor, or surety, can raise most defenses against the beneficiary that would be available to the party for whose promise the guarantor stands responsible.²⁵

Following World War II a new form of guarantee was needed in which the promise of the guarantor to pay the beneficiary was independent of the underlying transaction. As with the commercial letter of credit, the guarantor or issuer²⁶ would pay the beneficiary upon demand, or upon demand accompanied by specified documents. The innovation was that the documents would indicate that the account party had failed to perform its obligations under the underlying transaction rather than that the beneficiary had performed its obligations, as in the normal letter of credit. The guarantor or issuer would have no duty in regard to the underlying transaction; its duty would be limited to determining whether the demand for payment and the required documents, if any, were in the proper form.

In the United States, and a few other countries, the independent guarantee that was sought was furnished by adapting the traditional letter of credit to this new and nontraditional context, calling the result a stand-by letter of credit.²⁷ In most other countries banks gave the desired guarantee in the form of an unconditional contractual promise to pay upon demand or upon demand accompanied by documents. In many of those countries the issue of whether the courts would enforce the promise as written, or whether the promise would be categorized as a familiar suretyship type guarantee, was not clear for a period of time.²⁸ By the late 1980s

25. RESTATEMENT (FIRST) OF SECURITY, *supra* note 22, §§ 117-118.

26. The Working Group decided that, subject to review by the drafting group that would be established at a later session, it would retain both stand-by letter of credit and bank guarantee terminology and that it would use the double expression "guarantor or issuer." U.N. Doc. A/CN.9/372, ¶ 38. For the Secretariat's recommendation to use the single term "issuer," see U.N. Doc. A/CN.9/WG.II/WP.76, art. 2, remark 3.

27. The stand-by letter of credit was developed in the United States of America where the pledging of credit as surety and the issuance of guarantees is beyond the powers of banks as defined in statutes, charters and case law. . . . In other countries stand-by letters of credit are used, if at all, to a considerably lesser extent. Often the reason for doing so is that the commercial or banking relationship at hand involves a United States party. In other contexts, the reasons contributing to what appears to be an increasing use are probably to be found in the familiarity of business and banking circles with the traditional letter of credit and their perception of its legal certainty as compared with a possibly unsettled law on guarantees, in particular as regards the independence of the bank's undertaking from the underlying transaction.

U.N. Doc. A/CN.9/301, ¶¶ 25-26.

28. "This form of bank obligation has long been in use in Germany and Switzerland but was almost unknown in France or Belgium, where the suretyship (*cautionnement*) was used in similar circumstances." Jean Stofflet, *Recent Developments in the Law of International Bank Guarantees in France and Belgium*, 4 ARIZ. J. INT'L COMP. L. 48 (1987); see also Kozolchyk, *supra* note 13. Statutory provisions recognizing independent guarantees from Bahrain, Czechoslovakia, Democratic Yemen, German Democratic Republic (G.D.R.), Iraq, and Kuwait are set out and discussed in U.N. Doc. A/CN.9/WG.II/WP.65, ¶¶ 14-18. The Czechoslovak and G.D.R. provisions were in their international trade codes. That the other four countries were all beneficiary countries may be significant.

it was clear in most of the significant commercial states that the promises would be enforced as written and that an independent guarantee existed in addition to a suretyship type of guarantee. Although they were the fruit of freedom of contract, in the fundamental case in the United Kingdom, independent guarantees, labelled as performance bonds or performance guarantees, were said by the Court of Appeal to be "virtually promissory notes payable on demand" and furthermore, "the performance guarantee stands on a similar footing to a letter of credit."²⁹ The British courts were not the only ones to see the similarity between independent guarantees and letters of credit.³⁰

Nevertheless, the question remains whether stand-by letters of credit and independent guarantees should be treated as equivalent instruments to be governed by the same legal text.³¹ As pointed out by the ICC in the introduction to the URDG and by the United States delegation in the UNCITRAL Working Group, there are both historical differences in the development of the two instruments and some technical differences in the procedures followed.³² Further, some observers have argued that stand-by credits, but not independent guarantees, are often used to secure financial obligations.³³ However, that argument has been contested in the Working Group, where it was reported that "bank guarantees were used, like financial stand-by letters of credit, in financial markets."³⁴ The delegation of the United States has also

expressed the concern that the draft text disregarded the existing difference in terms of firmness between stand-by letters of credit and European-style bank guarantees and that it might be inappropriate to aim for a unitary set of rules that would do justice to neither type of undertakings, for both of which there was a demand on the market.³⁵

As a result the U.S. delegation submitted a proposal to the eighteenth session of the Working Group in which the two instruments would be treated in separate,

29. *Edward Owen Eng, Ltd. v. Barclays Bank Int'l Ltd.*, [1978] 1 Q.B. 159, 170-71 (C.A.).

30. In its decision of November 14, 1989, reported in French translation, 1992 D. Somm. 236, obs. Vasseur, the Supreme Court of Spain compared an independent guarantee to a documentary letter of credit governed by the UCP. See also Byrne, *supra* note 19, at 17. United States courts have characterized independent guarantees issued in foreign countries as stand-by letters of credit. *Egyptian Am. Bank, S.A.E. v. United States*, 13 Cl. Ct. 337 (1987), *aff'd*, 861 F.2d 728 (Fed. Cir. 1988); *American Nat'l Bank & Trust Co. v. Hamilton Indus. Int'l, Inc.*, 583 F. Supp. 164 (N.D. Ill. 1984), *rev'd on other grounds sub nom. Banque Paribas v. Hamilton Indus. Int'l, Inc.*, 767 F.2d 380 (7th Cir. 1985).

31. See *supra* notes 23-24.

32. Uniform Rules for Demand Guarantees, *supra* text accompanying note 21; U.N. Doc. A/CN.9/358, ¶ 14.

33. Uniform Rules for Demand Guarantees, *supra* text accompanying note 21; Kozolchyk, *supra* note 13, at 19.

34. U.N. Doc. A/CN.9/361, ¶ 72. The statement in the Working Group did not make it clear whether financial guarantees were issued only to single and exclusive beneficiaries or whether they were also issued to multiple beneficiaries or to fiduciary representatives of multiple beneficiaries, as is customarily done in the United States with financial standbys. See Kozolchyk, *supra* note 13, at 19.

35. U.N. Doc. A/CN.9/WP.II/WP.77, ¶ 1.

albeit parallel, parts of the convention.³⁶ The fate of the proposal is yet to be decided. On the basis of the discussion of the proposal in the Working Group, this writer concludes that it is likely to be rejected.³⁷ However, the delegation of the United States remains optimistic.³⁸

IV. Independence of the Guarantee: Simple Demand Guarantees and Nondocumentary Conditions

The concern of the delegation of the United States as to the difference in the firmness of stand-by letters of credit and European-style bank guarantees³⁹ brings into question the extent to which such guarantees are independent of the underlying transaction for which the guarantee has been issued. By definition a letter of credit contains an independent promise of the issuer to pay under the conditions specified in the credit.⁴⁰ A contractual guarantee, on the other hand, can be drafted with an infinite range of possibilities between a fully independent promise and one in which payment is conditioned on the issuer's determination that the principal obligor has failed in its promised performance.⁴¹

36. *Id.* The proposal of the United States would divide the convention into three parts, the first containing general provisions, the second and third containing provisions relating to independent guarantees and stand-by letters of credit respectively.

37. U.N. Doc. A/CN.9/372, ¶¶ 105-110. The proposal was not explicitly considered at the nineteenth session of the Working Group, but the question was raised on several occasions as to whether the Convention should provide different rules on particular points for stand-by letters of credit and for guarantees.

38. In a letter dated April 7, 1993, to the members and observers of the State Department Advisory Committee on Private International Law, Mr. Harold S. Burman, Executive Director of the Advisory Committee, stated that:

At the last meeting [of the Working Group], the U.S. delegation made headway on its proposal that a draft convention be prepared in three parts; . . . Such a convention, if it followed this general direction, would facilitate the use of both types of instruments by providing for mutual recognition and enforcement, in accordance with rules designed for each instrument. Thus, a bank guarantee issued in France would be entitled to enforcement in U.S. courts in accordance with rules designed for guarantees, and vice-versa for a standby issued in the U.S. on which enforcement is sought in another contracting State. . . . The U.S. has maintained throughout, while not being opposed to a unitary set of international rules, that the deliberations in UNCITRAL demonstrated that a single set of merged rules could not cover both types of instruments without compromising their intended commercial function, and that the market place would be unlikely to accept such rules as a result. We believe many delegates now concur with our assessment.

39. *Supra* note 35.

40. The statement in the text is conventional wisdom. However, U.C.C. § 5-103(1)(a) defines a "credit" or "letter of credit" as "an engagement by a bank or other person made at the request of a customer and of a kind within the scope of this Article (Section 5-102) that the issuer will honor drafts or other demands for payment upon compliance with the conditions specified in the credit." U.C.C. § 5-103(1)(a) (1989). Section 5-102(1)(c) in turn states that article 5 applies "to a credit issued by a bank or other person if the credit is not [documentary] but conspicuously states that it is a letter of credit or is conspicuously so entitled." U.C.C. § 5-102(1)(c) (1989). Although official comment No. 1 indicates that the purpose of subsection (c) is to permit the issuance of "clean" credits under article 5, the literal text of subsection (c) would also permit the issuance of a credit under article 5 that was conditional on an event other than demand or the presentation of specified documents. The proposed redraft of article 5 would make it applicable only to documentary credits. Mar. 31, 1993, Draft, *supra* note 23, §§ 5-102(a)(9), 5-103(a), and cmt. 6 to § 5-102.

41. For an argument that European independent guarantees are consistently less independent than stand-by letters of credit, see generally Kozolchik, *supra* note 13. In *IE Contractors Ltd v. Lloyds Bank & Rafidain Bank*, [1989] 2 Lloyd's Rep. 205 (Eng. Q.B.), the principal successfully contested

As a practical matter the independence of the guarantee is closely related to the requirement that the demand for payment be documentary in nature. The bank then would need to establish only that the "documents . . . appear on their face to be in accordance with the terms and conditions" of the guaranty letter without concern as to whether the documents accurately reflect the beneficiary's right to demand payment.⁴² The extent to which documents may be required arises in two contexts, simple demand guarantees and nondocumentary conditions.

A. SIMPLE DEMAND GUARANTEES

One of the primary battlegrounds on which the development of independent guarantees has been fought is the simple demand guarantee. In its truly simplest form, the simple demand guarantee authorizes the beneficiary to make demand for payment in any form, including oral, and at any time within the period of effectiveness of the guarantee without justifying the legitimacy of the demand. The possibilities for an improper demand by the beneficiary are obvious, however seldom such demands may occur in practice.⁴³ The possibilities for improper demand do not change by requiring the demand to be made in the form of a draft drawn on the issuer or in other written form, even though it has been said in the Working Group that such a demand is documentary in form.⁴⁴

One of the purposes of the 1978 URCG was to limit the possibility of improper demand of a guarantee issued under it. According to article 9 of the URCG, if the guarantee did not specify the documentation to be produced in support of a claim or merely specified the submission of a statement of claim, the beneficiary was required to submit (a) in the case of a tender guarantee, the beneficiary's declaration that the guarantee was due and an agreement to have any dispute

the debiting of its account by the counter-guarantor on the grounds that the demand by the beneficiary of the indirect guarantee "neither assert[ed] unequivocally a claim for damages owing to the beneficiary by GKN under the construction contracts, nor assert[ed] that the amount of damages so sustained was at least equal to the amount of the indemnity afforded by each of the [guarantees]." *Id.* at 210. In light of the decision in the case one commentator stated that "a bank should ensure that performance bonds and counter-guarantees are as unconditional as possible." Paul Howcroft, *Performance Bonds—the Tide Turns against the Banks*, 1990 J. INT'L BANKING L. 17, 23.

42. Cf. UCP art. 15.

43. Hans Giger, *Problems of Bank Guarantee Abuse in Swiss Law*, 4 ARIZ. J. INT'L COMP. L. 38, 40 n.15 (1987), states that one estimate of the frequency of conflict associated with guarantees used in foreign trade was 0.1 % (citing F. VON WESTPHALEN, *DIE BANKGARANTIE IM INTERNATIONALEN HANDELSVERKEHR* 155 (1982)).

44. U.N. Doc. A/CN.9/330, ¶ 69. The statement in the Working Group that stand-by letters of credit are invariably documentary, U.N. Doc. A/CN.9/358, ¶ 21, contemplates treating a draft or written demand for payment as a document. That would be consistent with the definition of "document" in draft revised U.C.C. § 5-102(6), which provides that a document includes "a draft or other demand." Mar. 31, 1993, Draft, *supra* note 23, § 5-102(6). In its eighteenth session the Working Group received, but did not discuss, a suggestion "to include within the definition of 'document' bills of exchange, promissory notes and demands for payment so as to avoid any uncertainty as to the applicability of the Convention to clean stand-by letters of credit and simple demand guarantees." U.N. Doc. A/CN.9/372, ¶ 100.

with the principal submitted to litigation or arbitration, and (b) in the case of a performance guarantee or of a repayment guarantee, either a court decision or an arbitral award justifying the claim, or the approval of the principal in writing to the claim and to the amount to be paid.⁴⁵ In addition to limiting the possibility of improper demand, those requirements effectively eliminated the simple demand guarantee.⁴⁶

Article 20 of the 1991 URDG does not go so far. It requires only that the demand be in writing and supported by a written statement that the principal is in breach of the underlying contract and in what respect the principal is in breach. The simple demand guarantee is thereby transformed into a documentary guarantee, with a required minimum content of the document.

Neither approach has been favored in the UNCITRAL Working Group. When the Working Group considered the draft URDG,

doubts were expressed as to whether a legal provision of the nature of article 20 could in fact discourage or encourage the use of a certain type of guarantee. Even if it had such potential, it was doubted whether a provision of contractual rules should be used for that purpose. Irrespective of the frequency with which this type of guarantee was used, it was submitted that a legal rule should take into account, and provide certainty for, all types of guarantees in use and leave the choice of the type of guarantee to be used to the credit decisions of the parties involved.⁴⁷

The UNCITRAL Secretariat sought to satisfy the concerns by proposing that the draft convention provide: "If no statement or document is required, the beneficiary, when demanding payment, is deemed to impliedly certify that payment is due."⁴⁸ Therefore, no document certifying to the propriety of the demand for payment would be required in the case of a simple demand guarantee or clean stand-by letter of credit. The Working Group was divided when it considered the proposal. Some thought that the convention should focus on guaranty letters payable upon presentation of documents in connection with the nonperformance of the underlying commercial obligation. That group favored a provision similar to article 20 of the URDG.⁴⁹ The majority in the Working Group, however, favored the suggested provision for the reasons previously given in regard to article 20 of the URDG.⁵⁰

There would seem to be two differences between requiring a written statement that payment was due and a legal presumption to the same effect. One difference

45. ICC Publication No. 325.

46. Article 9 caused some confusion since, "if the Rules . . . [are incorporated into] an on-demand guarantee, in order to be effective 'on demand' the guarantee must explicitly exclude Article 9 or state that the requirements for documentation . . . do not apply." Hjerner, *supra* note 9, at 76.

47. U.N. Doc. A/CN.9/316, ¶ 89.

48. U.N. Doc. A/CN.9/WG.II/WP.73, art. 14.

49. U.N. Doc. A/CN.9/361, ¶ 20.

50. *Id.* ¶¶ 21-22. At the nineteenth session the Working Group decided that the words "payment is due" should be replaced by a mention that the demand was not in bad faith or otherwise improper. U.N. Docs. A/CN.9/374, ¶ 85 and A/CN.9/374/Corr. 1.

is psychological: most people find it more difficult to lie overtly than to allow the same lie to arise out of a presumption of law. The other difference is legal: proving that the beneficiary had acted fraudulently would be easier if a false written statement had been made that payment under the guaranty letter was due than if only a simple demand for payment had been made.

B. NONDOCUMENTARY CONDITIONS

The problems arising out of conditions to payment not represented by a document have been more difficult for the Working Group to solve. The Working Group found that there was a wide range of nondocumentary conditions.

One category related to the establishment of the guarantee. For example, the establishment of a substitute guarantee might be conditioned on the return of the original guarantee instrument. A second category concerned pre-conditions for the effectiveness of the undertaking, for example, in an advance payment guarantee, that the advance payment had been made. A third category encompassed conditions in connection with the demand for payment that were mentioned in a guarantee without a stipulation as to how the fulfillment of the condition was to be evidenced. For example, a tender guarantee might be conditioned on the fact that the contract had been awarded, or a guarantee might state that payment was due if a certain event occurred that was or was not stated to be linked to an underlying transaction, or a counter-guaranty might be payable when the ultimate beneficiary demands payment from the beneficiary of the counter-guaranty. A fourth category concerned increases and reductions in the guarantee amount. For example, a guarantee might provide that the amount was to be increased in accordance with the opening of letters of credit by an importer or as the volume of goods delivered increased. Such automatic provisions were also associated with the reduction of the guarantee amount, for example, as deliveries or works progressed. A final category of nondocumentary conditions had to do with expiry clauses. For example, a guarantee might make reference to the completion of works or deliveries as the point of expiry. It was pointed out that such indefinite expiry terms were often accompanied by fixed, ultimate expiry dates.⁵¹

It would seem that all of the nondocumentary conditions mentioned in regard to guarantees could also apply to stand-by letters of credit.⁵² Observers could, of course, question whether some of those nondocumentary conditions that rely on knowledge within the purview of the issuer are really conditions.⁵³ Clearly, many of the delegates to the Working Group were of the view that they were conditions. Moreover, at the stage of drafting an international text that will eventually be

51. U.N. Doc. A/CN.9/358, ¶ 57.

52. A separate list of nondocumentary conditions often found in stand-by letters of credit was given in *id.* ¶ 58. The list was essentially a shortened version of the list of nondocumentary conditions found in guarantees.

53. Byrne, *supra* note 19, at 35-36, says that "events whose control is not exclusive to the party charged with performance but involve, in a sense, joint or coordinated performance with the obligor on the credit . . . are not true conditions." By way of example he cites "the prepayment of a sum of money to the bank (but only to the bank) as a precondition to the establishment of the credit." *Id.* at 36.

adopted in six official languages and will be interpreted in a large number of legal systems, it is safer to assume that an apparent nondocumentary condition is truly a condition even if it poses no problems of fact finding for the issuer. The text can then specify how such nondocumentary conditions should be treated.

The Secretariat's suggested solution to the problem was to specify that a guaranty letter was independent if it "contains [as its heading and] within its text the words 'Stand-by letter of credit' or 'Demand guarantee'." ⁵⁴ The Secretariat's proposal would have required that a demand for payment under such a guaranty letter be accompanied by the type of document required by article 20 of the URDG. ⁵⁵ The Working Group rejected the suggestion and requested the Secretariat to prepare a text based upon a proposal of the United States, which read as follows:

An undertaking is independent in that the issuer's performance to the beneficiary is not subject to or qualified by the existence or validity of an underlying transaction or of any terms other than those appearing in the undertaking or any condition, act or event other than presentation of stipulated documents. ⁵⁶

However, almost immediately after the Working Group decided to adopt the proposal of the United States, the statement was made that

it was not justified to frustrate the intention of the parties by disregarding a non-documentary condition or by requiring that the fulfillment of the condition be certified by the beneficiary. It was pointed out that in practice non-documentary conditions might be within or without the operational purview of the issuer. Some proponents of that view considered that certain less important non-documentary conditions might be disregarded or treated as documentary ones. . . . ⁵⁷

The final word on this issue has not yet been spoken.

V. Improper Demand

A. CRITERIA

A strict interpretation of the rule that the guarantee is independent of the underlying transaction would lead to the conclusion that neither fraud nor manifest abuse of rights by the beneficiary would constitute an objection to payment. ⁵⁸

54. U.N. Doc. A/CN.9/WG.II/WP.76, at 5. The proposed wording was basically the same as current U.C.C. § 5-103(1)(c) (1989).

55. U.N. Doc. A/CN.9/WG.II/WP.76, at 6. As indicated in the text *supra* at notes 49-51, in contrast to URDG art. 20, no document would be required in the case of a simple demand guarantee.

56. U.N. Doc. A/CN.9/372, ¶¶ 59, 62.

57. *Id.* ¶ 65. Section 5-110(d) of the Mar. 31, 1993, Draft of revised article 5, *supra* note 23, provides, "[i]f, despite the presence of non-documentary conditions, an engagement constitutes a letter of credit under Section 5-102(a)(9), an issuer shall disregard the non-documentary conditions and treat them as if they were not stated."

58. U.N. Doc. A/CN.9/358, ¶ 49. Similarly, illegality of the underlying transaction or violation of public policy would have no effect on the issuer's payment obligation. *Id.*

However, the nonfulfillment of the principal's obligation is the very contingency against which the beneficiary was intended to be secured.⁵⁹ Even in the case of a simple demand guarantee, the beneficiary can properly demand payment only if the principal is in default on the underlying transaction; any other demand would be improper.⁶⁰

The discussion in the Working Group as to what would constitute an improper demand has been particularly confusing, in part because the participants have suggested criteria that came from their national judicial experience. The terms "fraud" and "abuse of right" have been avoided, since they already have well-developed (and inconsistent) meanings in various legal systems.⁶¹ The difficulties are accentuated by the fact that the standards to be articulated are inherently vague and are to be applied in a wide variety of circumstances.

The only substantive grounds for calling a demand improper on which there has been general agreement is that the documents were forged.⁶² In regard to documents that contained false or inaccurate information, there was substantial sentiment that the demand would be improper only if the beneficiary had been aware of the inaccuracy at the time of making the demand, but no final decision has been made.⁶³ Of the other possible grounds suggested for considering the demand to be improper, the two that received the most vocal support were that the beneficiary prevented performance of the obligations in the underlying transaction that were secured by the guaranty letter and that the amount claimed by the beneficiary under the guaranty letter was disproportionate to the damage suffered.⁶⁴ However, while both might well be considered to be an improper demand in the abstract, they often call for refined determinations in regard to the underlying transaction, determinations that all agreed should not be thrust upon the issuer.

Article 19 of the second draft prepared by the Secretariat, which has not yet been discussed by the Working Group, sets out three substantive grounds for finding a demand to be improper:

- (a) [the beneficiary knows that] any document is forged;
- (b) the beneficiary knows or cannot be unaware that no payment is due [on the basis asserted in the demand and supporting documents]; or

59. *Id.* ¶ 51.

60. See text *supra* at notes 45-51. At the eighteenth session a proposal was made and rejected that the definition of "guaranty letter" should include the purpose for which the undertaking was given as an essential characteristic of the undertakings to be covered. U.N. Doc. A/CN.9/372, ¶¶ 28-34. The deemed certification that payment is due contained in article 14 does not, of course, preclude the possibility that the demand for payment is improper.

61. U.N. Doc. A/CN.9/361, ¶¶ 77, 80. The concept of fraud is often influenced by criminal law notions. U.N. Doc. A/CN.9/345, ¶ 40.

62. U.N. Doc. A/CN.9/345, ¶ 82.

63. *Id.*

64. *Id.* ¶¶ 86-87. Sometimes a proposal does not receive vocal support in a meeting because all participants support it. That may be why there were no comments on the proposal that a demand for payment of a repayment guaranty letter would be improper if no advance payment had been made.

(c) judging by the type and purpose of the guaranty letter, the demand has no conceivable basis.⁶⁵

Further refinement is offered in the following paragraph of article 19 as to situations in which “the demand has no conceivable basis.”

Improper demand under a counter-guaranty letter raises somewhat different problems. It is possible for the impropriety to arise under the counter-guaranty itself, such as when a demand for payment under the counter-guaranty letter is made although no demand had been made under the indirect guaranty letter.⁶⁶ The more typical, and more difficult, case is when payment under the indirect guaranty letter took place, but the payment was tainted with fraud of the ultimate beneficiary.⁶⁷ The question that has not yet been settled is the extent to which the beneficiary of the counter-guaranty letter, that is, the issuer of the indirect guaranty letter, must have been involved in, or be aware of, the fraud of the ultimate beneficiary.⁶⁸ The Secretariat’s second draft provides that a demand would be improper if:

In the case of a counter-guaranty letter, the beneficiary has not received a demand for payment under the guaranty letter issued by it, or the beneficiary has paid upon such a demand although it was obliged [under the law applicable to its guaranty letter] to reject the demand [as lacking conformity or as being improper].⁶⁹

B. REJECTION BY THE ISSUER

The Working Group recognizes that, in accord with practice in regard to both stand-by letters of credit and independent guarantees, the issuer has a restricted role in determining whether a demand is improper. The issuer must, of course, review the documents presented by the beneficiary to determine that they are genuine and consistent with the documents called for in the guaranty letter. In that regard the Working Group decided to adopt the two-pronged approach that is also used in article 13 of UCP 500. The issuer is held to a standard of good faith and reasonable care in examining the documents for discrepancies; to determine whether minor discrepancies should result in rejection of the documents, “the issuer shall have due regard to the applicable standard of international guarantee or stand-by letter of credit practice.”⁷⁰ The Working Group also decided that,

where a demand was neither improper nor in conformity with the terms and conditions of the guaranty letter, the issuer would be free to exercise its discretion in deciding whether to pay or not. However, where the issuer chose to pay upon such a demand, payment should not prejudice the rights of the principal.⁷¹

65. U.N. Doc. A/CN.9/WG.II/WP.76/Add.1, art. 19.

66. U.N. Doc. A/CN.9/361, ¶ 89. The indirect guaranty letter is the guaranty letter issued by a bank, normally in the beneficiary’s country, in favor of the beneficiary.

67. *Id.*

68. *Id.* ¶¶ 89-90.

69. U.N. Doc. A/CN.9/WG.II/WP.76/Add.1, art. 19(2)(e), variant Y.

70. U.N. Doc. A/CN.9/374, ¶¶ 93-95, 99.

71. *Id.* ¶ 107.

This two-pronged approach may usefully be compared to the approach taken in the current version of revised U.C.C. section 5-110(c).⁷² In regard to improper demands for payment the Working Group has agreed that where the fraud or abuse in the demand for payment is blatant, and could be perceived by anyone, the issuer will be obligated to refuse payment.⁷³

C. INJUNCTIONS AGAINST PAYMENT

Many countries, including the United States, authorize the courts to grant an order enjoining the issuer from paying or enjoining the beneficiary from receiving payment under the guaranty letter.⁷⁴ The convention obviously should also have provisions governing the issuance of such injunctions if it is to effectively unify the law of guaranty letters.⁷⁵ Yet, including procedural provisions in international texts for the unification of law is difficult. Judicial procedures vary widely, including in some countries the absence of an equivalent of a preliminary injunction.⁷⁶ Whatever provision might be adopted, it would introduce new judicial procedures into some of the legal systems that adopt the convention and those new procedures would apply to only a limited class of cases. Nevertheless, the Working Group decided that inclusion of provisions on preliminary injunctions against payment would "be beneficial for international uniformity and for protection of the integrity of the guaranty letter," provided that only the bare minimum necessary was included.⁷⁷

In a first discussion of the standards to be applied in regard to injunctions against payment, the Working Group decided that "the application of the principal must manifestly show that the demand was improper."⁷⁸ The Working Group was less certain whether the principal should be permitted to apply for an injunction prior to demand having been made by the beneficiary, especially since the

72. "Unless other standards are expressly incorporated by reference, sufficiency of compliance of a presentment is measured by commercial banking standards and practices." Mar. 31, 1993, Draft, *supra* note 23, § 5-110(c). Comment 1 explains that "[t]he section adopts the standard of strict compliance, but strict compliance does not mean slavish conformity to the terms of the letter of credit."

73. U.N. Doc. A/CN.9/361, ¶¶ 53, 88. At the nineteenth session the Working Group adopted the following text for draft article 17(2): "The issuer shall not make payment if it is shown facts that make the demand manifestly and clearly improper according to article 19." U.N. Doc. A/CN.9/374, ¶ 113.

74. U.C.C. § 5-114 (1989).

75. U.N. Doc. A/CN.9/361, ¶ 103. The conditions under which a preliminary injunction to payment can be issued because of improper demand affects the security of guaranty letters to beneficiaries in general. The conditions for granting permanent relief against improper demand seem to be of less importance, once the criteria of what constitutes an improper demand have been agreed upon.

76. *Id.*; U.N. Doc. A/CN.9/345, ¶ 58.

77. U.N. Doc. A/CN.9/361, ¶¶ 103, 114.

78. *Id.* ¶ 104. The Working Group thereby disapproved of the suggested standard of "strong prima facie evidence," "clear and liquid proof," and "manifestly shown by documentary means," the alternatives suggested by the Secretariat in its first draft of art. 21. U.N. Doc. A/CN.9/WG.II/WP.73/Add.1, *supra* note 2.

willingness of courts to grant such anticipatory relief would vary from jurisdiction to jurisdiction.⁷⁹ On the other hand, if the remedy was to be realistic, the principal had to have something more than the typically short period of time between the demand for payment and the payment itself. That issue was closely tied to the question, which has not yet been decided, whether the issuer would have to give notice to the principal (or to the instructing party) that demand for payment had been made.⁸⁰ Members of the Working Group expressed concern that such a notice requirement might compromise the independence of the guaranty letter. Furthermore, they observed that the procedure of giving notice was completely foreign to stand-by letter of credit practice.⁸¹

Other issues considered but not yet decided in regard to injunctions are whether the court should assess the relative harm that would be caused to the parties by a refusal to grant the injunctive relief; whether there should be a prohibition against the clause, sometimes included in counter-guarantees, requiring the counter-guarantor to pay even in the face of a court order prohibiting payment;⁸² whether the convention should cover injunctions not based on improper demand but on other objections to payment such as non-existence, invalidity, or unenforceability of the guaranty letter; whether it should be possible to enjoin the beneficiary from accepting payment; and whether the application for a preliminary injunction should be dealt with in *ex parte* proceedings, or whether the guarantor, and perhaps the beneficiary, should be given an opportunity to be heard.⁸³ In this latter connection it has been suggested that a procedure similar to the American *ex parte* temporary restraining order followed by a contentious decision on the issuance of an injunction might be followed.⁸⁴

79. U.N. Doc. A/CN.9/361, ¶ 106.

80. U.N. Docs. A/CN.9/345, ¶¶ 19-24; A/CN.9/361, ¶¶ 24-29; A/CN.9/374, ¶¶ 86-92. The obligation to give notice under article 15 would not be linked to the time available to examine the claim and decide about payment. In discussion it was said that,

Payment could be made (within the time allowed for examination of the claim) before notice was given (within the time period provided therefor), and non-compliance with the duty of notification would not affect the validity or effectiveness of payment but might under certain circumstances lead to a claim for damages.

U.N. Doc. A/CN.9/345, ¶ 23. The proposed rule was based on URDG art. 17.

81. U.N. Doc. A/CN.9/361, ¶ 26. In answer it was suggested "that the notice procedure, while possibly foreign to stand-by letters of credit, might nevertheless usefully be applied to them." *Id.* ¶ 27. It has also been said that giving notice to the principal was a common practice in stand-by letters of credit in some countries. U.N. Doc. A/CN.9/374, ¶ 89. *Contra* KWM Int'l v. Chase Manhattan Bank, N.A., 606 F.2d 10 (2d Cir. 1979), in which the Second Circuit required Chase Manhattan to give the applicant for the credit three days' notice before making payment on a stand-by letter of credit.

82. The injunction against payment by the counter-guarantor would presumably be based on the allegation that the demand for payment by the beneficiary of the indirect guaranty letter was improper, and that therefore the beneficiary of the counter-guaranty letter should not be reimbursed for its payment as issuer of the indirect guaranty letter.

83. U.N. Doc. A/CN.9/361, ¶¶ 107-110, 115-118.

84. *Id.* ¶ 110.

VI. Extend or Pay

It has been suggested that a demand to "extend or pay" could be handled without a special provision in the convention. One argument was that "extend or pay" is a subject that could easily be left to contractual regulation, as has already been done in article 26 of the URDG.⁸⁵ Another argument was that the request for extension could be considered to be a request for an amendment to the guaranty letter.⁸⁶ If the request for extension was refused either by the issuer or by the principal, the demand for payment would be examined by the issuer, and payment would be made if the demand for payment was proper and it met the terms of the guaranty letter.⁸⁷

This approach has not been adopted by the Working Group, at least for the time being. Some have argued that specific rules would be desirable to regulate the legal effect and procedures to be followed when an "extend or pay" demand is made.⁸⁸ Two approaches have been suggested for further discussion. The first would follow the approach taken in article 26 of the URDG. The issuer would notify the principal of the "extend or pay" demand; no extension would be given unless agreed to by both the issuer and the principal; if the request for extension was denied and the demand was proper, the issuer would pay it; the issuer might defer payment until ten days after original receipt of the "extend or pay" demand.⁸⁹ Under the second approach the demand for payment in an "extend or pay" demand would not be regarded as a proper demand for payment.⁹⁰ In order to achieve the same result as under the first approach, the beneficiary would have to make the request for extension in sufficient time before the expiration of the guaranty letter so that, if the request for extension was refused, a proper demand for payment could later be made before the expiration of the guaranty letter.

The delegation of the United States has resisted the extension of any rule on "extend or pay" to stand-by letters of credit. In its proposal submitted to the eighteenth session of the Working Group it said:

There is no law or practice for beneficiary demands or requests that a standby be extended or be paid other than the law and practice applied to demands for honor and to requests for amendment. The law should discourage beneficiary "extend or pay" demands on the issuer that are not provided for in the credit and therefore no provision for them should be made with regard to standbys.⁹¹

85. U.N. Doc. A/CN.9/345, ¶ 75.

86. U.N. Doc. A/CN.9/361, ¶ 65.

87. See U.N. Doc. A/CN.9/WG.II/WP.70, ¶ 51. As to whether a demand for payment coupled with a request for extension of the guaranty letter is inherently improper, since either the risk covered has materialized and no extension is needed or it has not yet materialized and the demand would fall outside the intended purpose of the guaranty letter, see *id.* ¶¶ 51-52.

88. U.N. Doc. A/CN.9/361, ¶ 66.

89. U.N. Doc. A/CN.9/WG.II/WP.76, art. 18, variant A.

90. U.N. Docs. A/CN.9/361, ¶ 70; A/CN.9/WG.II/WP.76, art. 18, variant B.

91. U.N. Doc. A/CN.9/WG.II/WP.77, ch. 3, art. 18 cmt.; accord U.N. Doc. A/CN.9/361, ¶ 67. The exclusion of stand-bys from any provision on "extend-or-pay" would be in accord with the UCP, which has no provision on the point in either UCP 400 or UCP 500. However, as noted *supra* note 9, the UCP contains no provisions specifically applicable to stand-bys.

A similar suggestion made at the seventeenth session of the Working Group to exclude stand-bys from any rule on demands to "extend or pay" was rejected on the grounds that the demands to "extend or pay" were made under stand-by letters of credit as well as bank guarantees.⁹² However, the matter will be considered again on several occasions before the final text of the convention is adopted.

VII. Jurisdiction

The tentative decision to include provisions on the power of a court to issue injunctive-type relief automatically raises the question as to whether the convention should have provisions on the applicable forum. Such provisions are not unknown in international conventions on substantive law.⁹³ However, inclusion of provisions on jurisdiction in substantive law conventions has become politically more difficult since the 1968 Brussels Convention on Jurisdiction and the Enforcement of Judgements in Civil and Commercial Matters has come into force among the Member States of the European Communities, and the substance of that convention has been extended to the Member States of the European Free Trade Area by the 1988 Lugano Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters. The parties to those conventions argue that "it would be difficult, if not impossible, for a State that adhered to any of those conventions to accept different rules and that difficulty might shape its position on the general question of whether the [convention] should include jurisdiction provisions at all."⁹⁴ When this matter was discussed in the seventeenth session of the Working Group some members suggested

that the Commission might wish to consider in a wider context, not limited to the specific area of guaranty letters, the relationship between universal and regional unification and discuss the desirability and feasibility of providing a universal framework on jurisdictional matters, building on relevant conventions dealing with such matters for regional purposes.⁹⁵

The suggestion has been overtaken by events in the Hague Conference on Private International Law where, at the suggestion of the United States, in May 1993 the Conference decided to include in its program of work "the question of the recognition and enforcement of foreign judgments in civil and commercial matters."⁹⁶

While the Working Group has not yet taken a final decision as to whether a provision on jurisdiction should be included in the uniform law,⁹⁷ it has made

92. U.N. Doc. A/CN.9/361, ¶ 67.

93. See, e.g., United Nations Convention on the Carriage of Goods by Sea (1978) (Hamburg Rules), arts. 21, 22, 17 I.L.M. 603.

94. U.N. Doc. A/CN.9/372, ¶ 123. This is becoming a familiar theme in the UNCITRAL in regard to both jurisdiction and conflict of laws provisions. See *infra* text at note 102.

95. *Id.* ¶ 124.

96. Final Act, Hague Conference on Private International Law, B.2.a.

97. U.N. Doc. A/CN.9/361, ¶ 132.

some decisions as to what such a provision would contain, if retained. As currently envisaged, they would do little more than recognize forum selection clauses, authorize the courts of contracting states to take provisional or protective measures and provide that, absent a forum selection clause, the courts of the country where the guaranty letter was issued would have jurisdiction over disputes between the issuer and the beneficiary and over applications by the principal for a preliminary order against payment.⁹⁸

VIII. Applicable Law

The question whether the convention should contain provisions on the applicable law has given rise to the same discussion as took place in regard to jurisdiction. Some participants argued that it would be inappropriate to include provisions on the applicable law in a convention that was devoted to substantive law matters.⁹⁹ The Member States of the European Communities might find it difficult to be party to a convention that contained rules on the same subject as the 1980 Rome Convention on the Law Applicable to Contractual Obligations.¹⁰⁰ Therefore, the decision to prepare provisions on the subject remains tentative.¹⁰¹

The current draft is quite short. If the parties have designated an applicable law in the guaranty letter or in a separate agreement, or the choice of law is "demonstrated by the terms and conditions of the guaranty letter," that choice is to be respected; no limitation is placed on the law that can be chosen, "because there [is] a practical need to allow parties to choose a law that [bears] no connection with the transaction, for example, because it [is] perceived as neutral or particularly refined."¹⁰² The latter argument, which may be relevant in general, would seem to be misplaced in this context. Any country that adopts the conflict of laws provisions of the convention will by necessity also have adopted the (neutral and refined) substantive provisions of the convention.

If the parties have chosen no law, the applicable law would be that of the place of business of the issuer of the guaranty letter, even if the place of payment was elsewhere.¹⁰³ Where the guaranty letter was issued by a branch of the issuer, the location of the branch would be the determining place. These simple rules, which are the current rules governing in most jurisdictions, are particularly appropriate to the relationship between the issuer and the beneficiary. However, the Working

98. See the Secretariat's second draft, U.N. Doc. A/CN.9/WG.II/WP.76/Add.1, at 13.

99. U.N. Doc. A/CN.9/345, ¶ 85. In a somewhat similar context, at the final stage of preparation of the UNCITRAL Model Law on International Credit Transfers the conflict of laws provision was deleted from the main text and placed in a footnote to the Model Law "for the use of States that might wish to adopt it." *Report of the U.N. Commission on International Trade Law on the Work of its Twenty-fifth Session*, U.N. GAOR, 47th Sess., ¶ 61, U.N. Doc. A/47/17 (1992).

100. U.N. Doc. A/CN.9/345, ¶ 101.

101. *Id.* ¶ 87; U.N. Doc. A/CN.9/361, ¶¶ 134, 139.

102. U.N. Doc. A/CN.9/345, ¶ 91.

103. U.N. Docs. A/CN.9/WG.II/WP.76/Add.1, at 15; A/CN.9/345, ¶¶ 93, 99.

Group has decided that the obligations of an advising bank should also be governed by the law of the issuer's place of business.¹⁰⁴ A particular problem arises in the case of a counter-guaranty, since two independent guaranty letters exist. Under the proposed conflict of laws rule both guaranty letters would be governed by the law of the issuer of that letter. The result would be that in most cases the indirect guaranty letter and the counter-guaranty letter would be governed by the law of two different states, the same result that obtains today.

IX. Conclusion

The UNCITRAL Convention on Guaranty Letters promises to be of great importance to the American legal, banking, and business worlds. Stand-by letters of credit are issued by American banks on the instruction of foreign parties, and for the benefit of foreign parties. American banks often issue these as counter-guarantees for guarantees issued by foreign banks at the instance of an American principal. Differences in the law between these instruments and between countries in regard to them place issuers, principals, and beneficiaries at risk of inconsistent treatment of the different parts of a single economic transaction. Although preparation of the convention is not yet complete, it promises to bring a welcome degree of order and uniformity to this important area of international economic activity.

104. U.N. Doc. A/CN.9/345, ¶ 99.

